



August 28, 2009

Division of Legislative Audit
Mr. Roger Norman, JD, CPA, CFE
Legislative Auditor
State Capitol Building
Room 172
Little Rock, AR 72201

RE: Response by the Arkansas Teacher Retirement System (ATRS) to the Audit Findings by the Division of Legislative Audit (DLA) on ATRS Activities for the Fiscal Year Ending June 30, 2008

Dear Mr. Norman:

On behalf of ATRS, I would first like to express my appreciation to the Division of Legislative Audit and to the DLA auditors at ATRS for their patience, courtesy, and understanding, as they had to deal with a new executive director learning the ropes and working through the issues at ATRS as an inexperienced director. ATRS pledges to work cooperatively with the Division of Legislative Audit to ensure that ATRS complies with all state rules, laws, and regulations and that ATRS staff follows the policies and guidelines set forth by the Board for ATRS operations. ATRS views the work of the Division of Legislative Audit as a tool for achieving excellence and will carefully evaluate the findings and recommendations of the Division of Legislative Audit in working toward the level of the excellence the ATRS Board and the ATRS Membership have a right to expect.

Response to Specific Findings

Findings 1, 2, and 3 on Contract Procurement

Finding 1: Franklin Park Associates, LLC. Rendering of services prior to the state contract execution date.

ATRS Response: First, ATRS acknowledges that the finding by DLA is correct. At the same time that DLA was investigating this matter, I as the new Executive Director was also simultaneously investigating this matter. This matter came to light when the consultant requested an escalator that they were entitled to receive after one year of performance of services, when, in fact, the year from the official contract date had not expired.

George Hopkins, Executive Director – 501-682-1820 – Email: georgeh@artsr.com

Once the improper early start date was found, ATRS notified DLA and began inquiring with the Department of Finance and Administration on how to correct this circumstance. This matter was also reported to the Office of State Procurement (OSP) as an admitted violation of state procurement law. ATRS requested and received approval from the Office of State Procurement to pay the additional amount owed to this consultant for work performed which had not been paid after I arrived as executive director. I ordered the payment to be withheld in order to comply with the actual execution date until OSP had resolved their review.

The consultant had believed the start time was proper and had acted on authority of ATRS staff. The consultant also fully cooperated with the review conducted by the executive director. After ATRS' commitment not to do these types of things again, OSP gave ATRS authorization to make the payment by ratification. ATRS paid the consultant and that matter, as to the consultant payment, was closed.

ATRS reviewed its internal controls and processes to ensure future compliance. ATRS staff has and is undergoing staff training and executive director emphasis on full compliance with all procurement rules and procedures. In addition, in order to have better recordkeeping processes and to have all necessary documents, and background on contracts, ATRS is implementing a process by which each ATRS contract is scanned into an image system. This system will include the negotiation documents, contracts, side letters, correspondence, all payments, and invoices. This will allow any person to fully view a contract file electronically and see all negotiations, invoices, state contracts, procurement dates, and details to further ensure that violations do not occur.

ATRS has placed an emphasis on complying with state procurement laws and legislative review requirements. ATRS will retain that emphasis as part of its processes. ATRS also requested the Office of State Procurement to provide a training seminar for ATRS staff members to ensure each staff member with procurement responsibility knows the full requirements of the OSP laws and rules. OSP has provided the ATRS training. ATRS will be seeking additional training as refresher training and as new staff is hired. Further, staff has been instructed to notify internal audit or the executive director in the event they think a contract process did not follow state procurement requirements

Finding 2: Ennis Knupp and Associates. Rendering of services prior to the state contract execution date.

ATRS Response: ATRS acknowledges that the finding of the Division of Legislative Audit is correct. This is another contract that came to the executive director's attention soon after arriving at ATRS. At the same time DLA was investigating this matter, the executive director was also investigating the matter. This matter, along with the issue in

Finding #1, was reported to DLA and to the ATRS Board soon after the executive director arrived at ATRS. In addition, this matter was also reported to the Office of State Procurement as an admitted violation of state procurement law.

A specific request was made to the Office of State Procurement for ratification of the amount already paid to this vendor prior to a legal contract existing. ATRS determined that, even though payment to this vendor had been made, that the Office of State Procurement should ratify the payment to clarify the failure by ATRS staff. The Office of State Procurement did ratify the payment on condition that ATRS acknowledged that it had failed to follow the Office of State Procurement requirements and that ATRS was committed to not allow these types of violations to happen again.

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Finding 3: DLA Piper, LLC. Engagement of a law firm without documentation, without required approvals by the Attorney General and OSP, and with payment of the fees being made by a third party vendor on behalf of ATRS.

ATRS Response: ATRS agrees that the finding of DLA is correct. ATRS staff involved in this matter has been notified and cautioned that all contract laws of the state of Arkansas must be followed on each contract. Further, all ATRS staff has been notified that it is important to ensure compliance with state laws under all circumstances. ATRS

staff now clearly knows the focus at ATRS must be to protect the integrity of the system and the confidence of the public and ATRS members in ATRS at all times.

ATRS also performed a review of this matter while DLA was reviewing this matter. The executive director asked Oppenheimer, the third party vendor, to refund all the attorney fees that ATRS paid through management fees to Oppenheimer. That request was rejected. However, Oppenheimer did reimburse ATRS for approximately \$3,600 of the attorney fees, which represented the amount of the total fees paid to Oppenheimer, which exceeded the state maximum limit for fees under the Oppenheimer contract.

ATRS has emphasized to all staff that circumstances such as these are not acceptable. Further, if an important risk exists, the approach must always be to share information with other agencies that have authority over the issue to attempt to find a resolution without failing to comply with laws concerning hiring of outside counsel and state procurement laws. Again, training from the Office of State Procurement was provided to ATRS staff. In addition, it has been made abundantly clear at ATRS that compliance with state procurement laws are an emphasis that must be recognized when staff is dealing with the numerous contracts with outside vendors.

Contracts such as these must also be put into the image system that ATRS is developing in order that all invoices, engagement letters, and activity concerning each contract will be available to ATRS staff and the Division of Legislative Audit.

**Conclusion on failure to follow state procurement laws
as outlined in findings 1, 2, and 3.**

Overall, ATRS acknowledges its failure to follow state procurement laws in the instances addressed in the findings by the Division of Legislative Audit. The focus of ATRS staff on procurement compliance in the audit period was inadequate. ATRS staff is embarrassed by its failures in this regard. The ATRS Board has made it clear to ATRS staff that this area must be corrected. The ATRS staff is committed to ensure compliance with state procurement laws at all times.

ATRS has instructed its internal audit department to sample and ensure compliance with state procurement laws as a part of the internal audit review process. In addition, ATRS intends to have multiple staff members involved in virtually every contract process to question and ensure that the state procurement process is being followed in each separate contract.

Notification of ATRS procurement failures to the Office of State Procurement, resolution of other procurement issues through the passage of Act 1211 of 2009, and a clear directive from the director to focus upon procurement at all stages of negotiation are

intended to address and eliminate these failures. The new image system for contracts and internal audit's future sampling of contracts for procurement compliance should also help address the area. ATRS staff is committed to preventing these failures in the future.

Response to Findings 4, 5, and 6

Finding 4: Failure to deposit contributions in a timely manner, receipts not yet deposited, being recorded as accounts receivable, the check receipt log not being reconciled to receipts, and check scans being placed in the wrong files.

ATRS Response: ATRS agrees that the finding of DLA is correct on these findings. These findings relate to checks that are mailed to ATRS. The old process that had been in place prior to this finding ensured that all checks would be left at ATRS at least 24 hours and never deposited on the same day as received. The executive director of ATRS met with the staff members involved in the process after this finding came to light. The focus on ATRS is now to always ensure timely deposits.

The old process in place prevented timely deposits. Potential solutions were discussed and reviewed. A new process has been established. Under the old process, the deposits were only made once a day by ATRS at 10:00 each morning. Checks could not be worked and appropriately journaled by ATRS staff before 10:00 in the morning. This created a result that always ensured an overnight stay of all checks at ATRS. A new process is being implemented that has an afternoon deposit time for checks. Most checks received in a day will be deposited. Staff has been instructed to not let checks remain over long periods of time at ATRS as happened in the past.

In addition, ATRS is in the process of making software adjustments for ATRS employers that will allow most contributions to be made via an electronic funds transfer (EFT) process to eliminate all risk factors of paper checks. The EFT process will not only expedite deposits, it will further provide efficiencies in obtaining money on an immediate basis to ensure ATRS is not withdrawing invested money and losing investment returns in order to meet monthly retiree payroll requirements.

ATRS has also informed Internal Audit at ATRS that it must constantly monitor this high-risk function and ensure that the timely deposit of all checks being received continues to occur. ATRS will work diligently to ensure that this finding is addressed through proper internal controls and procedures to ensure timely deposits of all paper checks.

ATRS acknowledges the accounting issues in the financial statement of ATRS caused by a large number of checks not being deposited on a timely basis. The new process

should prevent this problem by timely deposits. In addition, ATRS staff will monitor checks received at fiscal year end and ensure the checks are recorded appropriately as a current asset and not as an accounts receivable item.

As to the check log not being reconciled to deposits, ATRS has implemented new procedures to ensure that the check log is reconciled to deposits. ATRS will carefully monitor check reconciliation to ensure this problem is and remains resolved. Internal Audit will also review and audit the entire check receipt and recording process to ensure compliance on all these DLA findings.

Finding 5: Real Estate extension of maturity dates of loans without Board approval and the Director of Real Estate taking action before Board authority was granted.

ATRS Response: ATRS agrees that the finding of DLA is correct. ATRS has added staff to real estate and investment accounting. ATRS has hired a new Director of Real Estate with a vast amount of real estate experience. The changes to the real estate area have brought an emphasis on excellence in the real estate area. The last loan approved by ATRS, the Peabody Hotel loan, went through the proper procedures. Until the new Director of Real Estate was hired, the executive director had assumed the function of Director of Real Estate.

ATRS is now placing the maturity dates of loans onto a tickler system to ensure that prior to loans maturing, ATRS management and the ATRS Board have a proper opportunity to review the loan and negotiate terms of extensions or payoffs that are beneficial to ATRS. Investment staff has been given clear instruction that staff must give notice of needed action at appropriate times to ensure proper Board input on all matters where Board approval is required. ATRS looks forward to implementing its plan of taking an area that has historically been the subject of many DLA findings and making it an example of quality.

Finding 6: Failure to have proper logon and password usage controls.

ATRS had been using a 5-character password and did not change passwords unless an individualized need for a change arose. On the day that this finding was given to ATRS staff, the Data Processing department began to develop a plan to comply with the requirements. As of September 1, 2009, ATRS will use an 8-character password with a mixture of alpha and non-alpha characters and the passwords will change for all staff every 90 days. Passwords may not be reused within a 6-password change. ATRS will monitor any new requirements with a stated process to implement all required changes. Internal Audit will monitor this area for continued compliance.

Roger Norman
Page Seven

Conclusion

On behalf of the ATRS staff and ATRS Board, I state that ATRS is committed to its fiduciary obligations to its members and its responsibility to the public. ATRS has many specialized functions. ATRS is committed to improvement throughout its organization to become a source of excellence whenever possible. ATRS staff is striving to find weaknesses and to address those weaknesses systematically as a team. ATRS staff appreciates the full courtesy and cooperation shown by the Division of Legislative Audit, the Office of State Procurement, and other agencies that have been involved in assisting ATRS in addressing issues that have arisen this year. I am pleased to provide the ATRS response to the Division of Legislative Audit's findings. ATRS stands ready to address and expand upon any issue not fully addressed in this written response.

Respectfully,

George Hopkins
Executive Director